

DEPARTMENT OF STATE REVENUE**LETTER OF FINDINGS NUMBER: 96-0301 ITC
ADJUSTED GROSS INCOME TAX
For Years 1992, 1993 AND 1994**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES**I. Adjusted Gross Income Tax – Foreign Dividend Deduction**

Authority: IC § 6-3-2-12

The taxpayer protested the auditor's adjustments adding back taxpayer's dividend expense deductions on Federal Form 1118 to taxpayer's foreign dividend income deduction when calculating Adjusted Gross Income.

II. Adjusted Gross Income Tax – Procedural Issues

Taxpayer requests correction of computation error in audit report.

III. Adjusted Gross Income Tax - Business Income

Authority: IC § 6-3-1-20; 45 IAC 3.1-1-60

Taxpayer protests the reclassification of dividends from a subsidiary corporation as business income.

STATEMENT OF FACTS

Taxpayer manufactures and distributes hospital and laboratory products, pharmaceutical, and nutritional products worldwide. Taxpayer has a district sales office in this state. Taxpayer protested based on the addition of taxpayer's foreign operation's expenses to taxpayer's foreign operation's income and the reclassification of dividend income from nonbusiness to business income as well as an arithmetic error.

I. Adjusted Gross Income Tax – Foreign Dividend Deduction

DISCUSSION

In calculating its Indiana tax liabilities, taxpayer, pursuant to IC 6-3-2-12, deducted foreign source dividend income from its Indiana adjusted gross income. Audit, however, disagreed with taxpayer's calculus. Specifically, Audit discovered that taxpayer failed to reduce its foreign source dividend income deduction by the sum of all expenses related (deemed or otherwise) to the earning of such dividend income. To "cure" this oversight, Audit, "netted" taxpayer's dividend deductions by all related expenses. Re-calculation resulted in an increase in taxpayer's Indiana adjusted gross income and tax. Proposed assessments of Indiana adjusted gross income tax followed.

Taxpayer, in response, contends the language of IC 6-3-2-12 neither commands nor suggests reducing the foreign source dividend deduction by related expenses. To buttress its contention, taxpayer directs the Department's attention to the language of IC 6-3-2-12(b), which states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

- (1) the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year; multiplied by
- (2) the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred percent (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50%-79%) percent ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which a taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c)-(e).

Taxpayer argues that reducing its foreign source dividend deductions by related expenses effectively prevents taxpayer from deducting these statutorily mandated amounts (i.e., percentages). Taxpayer also notes that conspicuously absent from Indiana's taxing scheme is any statutory or regulatory language authorizing the Department, or requiring the taxpayer, to "addback" expenses related to the earning of excluded (i.e., deducted) foreign source dividend income.

The Department finds merit in taxpayer's arguments. Simply stated, IC 6-3-2-12 authorizes pro rata deductions (based on the percentage ownership of the payor by the payee) of certain foreign source dividend income. Neither IC 6-3-2-12 nor any other statute or regulation requires this pro rata deduction to be reduced by related expenses. Absent such authority, the statutorily mandated pro rata deduction may not be "adjusted."

FINDING

Taxpayer's protest is sustained.

II. Adjusted Gross Income Tax – Procedural Issues

DISCUSSION

As part of the appeal, taxpayer requests a computation correction. Taxpayer indicates the reduction of the 1992 nonbusiness income was erroneously increased by \$800,000 in carrying the total forward from audit workpaper page 7 to page 13. The adjustment according to page 7 is 89,024,643, not \$89,824,643. This request involves no legal issues, rather it is a possible oversight in the computation of liability by the auditor.

FINDINGS

Taxpayer's protest is sustained subject to audit verification.

III. Adjusted Gross Income Tax - Business Income

Taxpayer requests dividends from subsidiary corporation be treated as non-business income. IC § 6-3-1-20 defines business income as:

The term "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.

45 IAC 3.1-1-60 further defines business income to be:

Sec. 60 Dividends. Dividends are nonbusiness income if the stock with respect to which the dividends are received did not arise out of or was not acquired in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the stock is not related to or incidental to such trade or business operation.

Examples:

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(5) The taxpayer receives dividends from the stock of its subsidiary or affiliate which acts as the marketing agency for products manufactured by the taxpayer. The dividends are business income.

Taxpayer owns 50% of the subsidiary in question. Taxpayer has an agreement with subsidiary to co-promote one of taxpayer's products in the U.S, as well as negotiating separate marketing rights for the product in Latin America.

Taxpayer's ownership in the subsidiary extends beyond a passive investment and is part of taxpayer's business operation. The income was correctly classified as business income.

FINDINGS

Taxpayer's protest is denied.

JM/PE/MR 011105